FILED
MAY 1 2 1967
JOHN F. DAVIS, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. 952

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.
Petitioner,

-vs-

C. GORDON ANDERSON, TRUSTEE,
Respondent.

REPLY OF RESPONDENT TO MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

William P. Simmons, Jr.
of SHUTTS & BOWEN
1000 First National Bank Bldg.
Miami, Florida 33131
Attorneys for Respondent

INDEX

	Page
Statement	1
The Contention that the Trustee should not be permitted to be employed by the reorganized debtor.	5
The Contention that certain stockholders should be afforded opportunity to participate in the reorganized debtor.	12
The Contention that compromises of major claims were improperly approved by the court.	22
The Debtor is insolvent and the stockholders must be excluded from participation.	27
Conclusion	28
Appendix:	
Portions of Trustee's Motion for Allowance of claim.	App. 1

CITATIONS

	Page
Ashbach v. *Kirtley*, 289 F.2d 159 (C.A. 8, 1961)	26
Burleson v. *Davis*, 141 S.W. 559 (C.App.Tex.1911)	19
Clark v. *Boston-Continental National Bank*, 84 F. 2d. 605 (C.A. 1)	17
Comstock v. *Institutional Investors*, 335 U.S. 211	29
Consolidated Rock Products, Inc. v. *DuBois*, 312 U.S. 510	28
Cook County v. *United States*, 107 U.S. 445	16
Daniel Hamm Drayage Co. v. *Willson*, 178 F.2d 633, 635 (C.A. 8, 1949)	25
Davis v. *Burns*, 173 S.W. 476 (C.App. Tex 1915)	19
General American Life Ins. Co. v. *Anderson*, 156 F.2d 615, 618-619 (C.A. 6, 1946)	5
Green v. *Stone*, 205 Ala. 381, 87 So.862 (1921)	19
In re Chicago Rapid Transit, 196 F.2d 484 (C.A. 7, 1952)	26
In re Irving Whitehouse Co., 293 Fed. 287 (C.A. 9, 1923)	20
In re Kalamazoo Building Co., 21 F.Supp. 852 (D.C. Mich., 1937)	26

CITATIONS (cont.)

	Page
In re Prudence Co., Inc., 98 F.2d 559 (C.A. 2, 1938) *cert. denied sub. nom. Stein* v. *McGrath*, 306 U.S. 636	25
In re TMT Trailer Ferry, Inc., 334 F.2d 118 (C.A. 5)	5
Institutional Investors v. *Chicago, M. St. P. & P.*, 318 U.S. 523	28
National Surety Co. v. *Coriell*, 289 U.S. 426	26
Oppenheimer v. *Harriman National Bank & Trust Co.*, 301 U.S. 206	18
Salter v. *Williams*, 244 Fed. 126 (C.A. 3)	18
Texas & Pacific Railway Co. v. *Pottorff*, 291 U.S. 245	17
TMT v. *Anderson*, 292 F.2d 455 (C.A. 5), *cert. denied*, 368 U.S. 956	2
United States v. *Anderson*, 334 F.2d 111 (C.A. 5), *cert. denied*, 379 U.S. 879	3
Statutes:	
Bankruptcy Act:	
Section 158	11
196	21

STATUTES (cont.)

Page

197 20

209 22

210 22

211 (4) 22

216 (11), (14) 8

228 5

National Bank Act:

12 U.S.C. 21 16

12 U.S.C. 194 16

Miscellaneous:

Ferber, Conflicts of Interest in Reorganization Proceedings, etc., 28 Geo. Wash. L. Rev. 319 (1959-60) 11

H.R. 11589, 85th Cong., 2nd sess. (1958) 11

Twenty-Fourth Annual Report, Securities and Exchange Commission 11

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. 952

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.
Petitioner,

-vs-

C. GORDON ANDERSON, TRUSTEE,
Respondent.

REPLY OF RESPONDENT TO MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

STATEMENT

The court invited the Solicitor General to file a brief expressing the views of the United States in this case, and he has submitted a memorandum "for the Securities and Exchange Commission."

The Solicitor General's memorandum fails to mention the interest that the United States has had in this case as a

major creditor of the debtor, an interest of more direct concern than the purely advisory function of the SEC under Section 172 of the Bankruptcy Act. The tax claims of the government totaled approximately $192,000 and the non-tax claims about $905,000 (III 224).

The initial plan of reorganization confirmed by the district court on March 6, 1959 (II 516-519) was rejected by the government because of inadequate provisions for payment of its claims. Negotiations thereafter between counsel for the Trustee and counsel for the government (represented by the Admiralty and Shipping Section, Civil Division, Department of Justice) resulted in settlement of those claims, and the plan was amended on November 4, 1959 (II 564-571) to provide for payment of the tax claims in installments over a 3 year period and for the government to receive for the non tax claims 27½% of the face amount of the claims in preferred stock of the reorganized debtor. The plan as thus amended was accepted by the Secretary of the Treasury (II 559-564).

This is the plan referred to by Petitioner (sometimes herein called the Stockholders Committee) as the Shaffer-Spitzer plan after the names of the trustees for the Caplan mortgage group. This plan was set aside after the Trustee's investigation in 1960 resulted in his recommendation to the court that the plan was not fair and equitable because of control being given to the Caplan mortgage group.

After the appellate court sustained the setting aside of the plan (*TMT* v. *Anderson*, 292 F.2d 455, *cert. denied*, 368 U.S. 956) the present plan of reorganization was evolved after a series of hearings and after negotiations involving settlements of various claims. The proceedings involving

the new plan were not concluded until mid-year 1962 or 3 years after the initial plan was approved. During this period the debtor prospered under the management of the Trustee. Net profits were $207,000 in 1959, $210,000 in 1960, $373,000 in 1961 and $524,000 in 1962 (III 77). As a result of these earnings and a going concern value of $2,780,000 found by the court based on the earnings (II 387.5) counsel for the United States insisted that the debtor could afford to pay the government *in full* and contended that the law required priority treatment not only of the tax claims but also of the non-tax claims for which in 1959 settlement was made at 27½¢ on the dollar taken in preferred stock.

We were unable to reach a settlement of the non-tax claims and the litigation over them resulted in the appellate court upholding the government's contention that they were entitled to priority the same as tax claims. (*United States* v. *Anderson*, 334 F.2d 111, cert. *denied*, 379 U.S. 879) This decision resulted in the amendment of the plan to provide for payment in full in cash of all the government claims totaling about $1,097,000 and the plan as so amended was approved by the district court on March 19, 1965 (III 260-271). In order to pay these claims in cash and meet other cash requirements for the consummation of the plan, the plan was further amended at the same time to authorize the reorganized company to borrow $1,250,000 from a bank on a long term loan secured by a mortgage on its vessels and vehicles.

Thus, it is apparent that the government as a major creditor has benefited materially from the success of the trustee in operating the business of the debtor. This success alone has enabled the government claims to be paid in full

because the value of TMT, as admitted by all parties, is not in its assets but in its going concern value as a transportation facility. It is therefore inconsistent for the Solicitor General in his brief to criticize that portion of the plan of reorganization, accepted and desired by the other creditors, which will enable the directors of the reorganized company to retain the valuable services of the Trustee if they desire to do so.

It is this amended plan which is the subject of the Petition in this cause. The district court directed the Trustee to proceed with the consummation of the plan on May 25, 1965 (III 389-395). Pursuant to this and subsequent directives which are not in the record before the court, the Trustee has substantially consummated the plan although no formal order of substantial consummation is contemplated until the proceedings in this court are concluded.

The government has, in fact, been paid approximately $1,100,000 on account of its claims, and all other claimants have likewise been paid. The reorganized company borrowed $1,250,000 in order to make these payments, as authorized in the amended plan. The common or unsecured creditors have been issued the new common stock of the reorganized company in satisfaction of their claims. The directors of the reorganized company, appointed pursuant to the plan in the order of May 25, 1965, supra, have taken over the assets of the debtor and are running its business.

The purpose of this discussion is to show the importance of the stake that the government has in TMT as a major creditor, in fact the largest creditor except for Merrill-Stevens, an unsecured creditor. As a large preferred creditor whose claim has been allowed and paid, the

government should be concerned with upholding the plan and bringing to a conclusion the extended litigation that has prevented its final consummation. We are unable to predict what the effect might be on the government's position as a creditor should this court require the forming of a new plan with provisions materially different from the present one as sought by the Stockholders Committee. It is our opinion that until a Final Decree is entered, as provided in Section 228 of the Bankruptcy Act, discharging the debtor from its debts, there remains the possibility of redetermination with respect to any issue involved in the reorganization including those providing for the payment of any claims.

It appears that the government's interest as a major creditor is adverse to its championing the interests of a Stockholders Committee. The Solicitor General should have taken a position the same as other creditors, namely that the rights of stockholders have been thoroughly considered and determined in the lower courts and that the plan of reorganization should not be disturbed by this court.

THE CONTENTION THAT THE TRUSTEE SHOULD NOT BE PERMITTED TO BE EMPLOYED BY THE REORGANIZED DEBTOR.

This issue is not properly before the court because it was not decided by the Fifth Circuit in the opinion which is the subject of these proceedings. It was decided by the Fifth Circuit in the *prior appeal (In re TMT Trailer Ferry, Inc.*, 334 F.2d 118, dated June 8, 1964) and thereby became the law of the case.* The opinion sought to be

*See: *General American Life Ins. Co.* v. *Anderson*, 156 F.2d 615, 618-619 (C.A.6, 1946).

reviewed here (App. 6a, Petition for Writ of Ceriorari herein) is dated August 12, 1966, and does not discuss this issue but merely mentions in passing that it was decided in the former appeal.

The entire argument of the Solicitor General on this point is directed to the Fifth Circuit opinion in the 1964 decision and not to anything in the opinion sought to be reviewed. He tries to get around this by asserting on page 9 of his brief that the issue "was not then ripe for review" (in 1964) but "is now ripe" since the "final plan . . . contemplates that the trustee will become president." This is not accurate for the issue was as ripe then as it is now.

The plan of reorganization, as revised by the District Court following the 1964 remand, contains the *identical* provisions with respect to the officers, directors and corporate structure of the reorganized debtor as was contained in the plan reviewed by the appellate court in 1964. With respect to the possible employment of the Trustee, the language in the plan is:

> "It is necessary that competent management, which might include present management, be employed to operate the reorganized company and that any such management contract is to be approved by the new Board of Directors and the court." (III 247)

The district court in its order approving the amended plan (App. 14a, Petition for Writ of Certiorari herein) made it plain that no new plan of reorganization was being considered but that the plan was being amended only to meet the requirements of the appellate court with respect

to the priority of the government non-tax claims and to make certain other minor clarifying changes. The district court opinion and order does not discuss the issue of the Trustee's employment *because it was not raised* when the amended plan was considered. The record shows that when the matter was heard (III 351-357) the court asked twice (III 356) if there were any comments or objections to the names of those proposed for appointment as the new directors of the reorganized company and there were none *even from counsel for the Stockholders Committee* who was present. The Trustee was one of the new directors.

The raising of this issue before this court on behalf of the Securities and Exchange Commission is even more inexplainable because the SEC did not object to the provision in the amended plan for the employment of the existing management. The SEC filed a lengthy report on the amended plan (III 215-242) but it made no comment on the subject except to note that the Fifth Circuit 1964 opinion "sustained the provisions in the Internal Plan with respect to the employment of the Trustee as president of the reorganized company." (III 223) Nor did the brief filed by the SEC in the appeal of the present plan to the Fifth Circuit discuss the issue of the employment of the trustee.

It is apparent that all parties, including the district court and the appellate court, considered that the 1964 opinion of the Fifth Circuit settled the issue. It became the law of the case and is not a proper subject for further review.

Regarding the merits of this issue, the court should decline what amounts to a suggestion by the Solicitor General that the court amend the Bankruptcy Act to include a

standard for determining disinterest which was omitted by the Congress. Section 158 of the Bankruptcy Act specifies who shall be considered a disinterested trustee and it fails to state that an interest in the management of the debtor after its reorganization is a disqualification. It is significant that the record of these proceedings, now in their tenth year, contains no assertion that the Trustee, who has served from the beginning, is in any way disqualified to act even though he was tagged as far back as the initial 1959 plan of reorganization to be the president of the reorganized company. If the Solicitor General's contention is correct the Trustee has been disqualified to serve for many years.

Section 216 of the Bankruptcy Act specifies what a plan of reorganization must contain and provides:

> "(11) shall include provisions which are equitable, compatible with the interests of creditors and stockholders, and consistent with public policy, with respect to the manner of selection of the persons who are to be directors, officers, or voting trustees, if any, upon the consummation of the plan, and their respective successors;"
>
> * * * *
>
> "(14) may include any other appropriate provisions not inconsistent with the provisions of this chapter."
>
> Sec. 216 (11) and (14) of the Bankruptcy Act.

The opinion of the district court, prior to the 1964 decisions of the Fifth Circuit, in approving the provision in the plan authorizing the continuation of the Trustee's

management made specific findings implying that the provision in this case was in the best interests of the parties concerned. The court said:

> "The SEC memorandum also objected to the provision in the Internal Plan which contemplates that the reorganized company may employ the Trustee as its president. This provision, however, is not mandatory on the reorganized company and was inserted at the insistence of the court for the purpose of making full disclosure of what had come to the attention of the court. Both the trustee and the creditors' committee had advised the court that certain of the largest unsecured creditors who favored an internal plan wanted the present management retained. There is nothing in the law which precludes a trustee from accepting employment from the reorganized company, and certainly the creditors concerned are entitled to insist on good management acceptable to them." (II 378)

The background of this finding is important. The plan finally approved was initially proposed by a *court appointed committee of attorneys* (II 41), experienced in bankruptcy matters, charged with protecting the interests of unsecured creditors as a class. This committee included in the initial draft of the plan later adopted a provision expressly contemplating the retention of the present management by the reorganized debtor (II 41.11) and suggested a form of contract which was eliminated from the plan before it was approved. It was finally decided to leave to the discretion of the directors of the reorganized company whether the trustee and his staff would be retained, and the present provision in the plan was inserted in order to advise every-

one concerned that retention of the Trustee was under consideration.

The arguments advanced by the Petitioner and the Solicitor General are designed to lead the court to believe that the principal objective of the Trustee was to make a job for himself. Petitioner's counsel condemns the alleged conflict of interest with denunciatory fervor that is scandalous in its implications. The truth is that the trustee has done a rare and exceptionally competent job in the operation of the business of the debtor, taking over when operations had ceased and developing traffic successfully in the highly competitive maritime field and without the benefit of the government subsidies necessary to keep many of the large shipping companies alive. It was almost inevitable that under such circumstances the creditors concerned would want this successful management retained, or at least not be *precluded* from using the trustee and being *forced* to employ some stranger to the operation.

The argument of the Solicitor General is not sound. He engages in the assumption that as a matter of law a trustee who *intends* or *contemplates* that he will become president upon reorganization *necessarily* has an interest adverse to the interests of creditors and stockholders. This assumption belies human nature for a person with an incentive will do a better job than one marking time knowing there is no future for him. In any event, as the Fifth Circuit decision held, the TMT Trustee is not *assured* of future employment but his job will depend entirely on the new directors.

Nor did Congress ever intend to make the test of "disinterest" dependent upon the subjective *intention* or

contemplation of the trustee. The statutory tests in Section 158 of the Bankruptcy Act are all objective tests, and the Solicitor General would write into the section words and meanings that are not there.

Congress was given an opportunity to write into the statute the very intent urged by the Solicitor General, but failed to act. On March 24, 1958, Congressman Celler introduced H.R. 11589, which proposed that Section 216 of the Bankruptcy Act (describing the provisions to be included in a reorganization plan) be amended. The bill was referred to the Committee on the Judiciary, which apparently did not act upon it except to the extent indicated in the next paragraph.

SEC's 24th Annual Report (pp. 9-10) says that H.R. 11589 was one of nine draft bills to amend the Bankruptcy Act which SEC itself filed with the Judiciary Committees of the House and Senate. The Report then states of these bills that

> "... They were referred to the Judicial Council of the United States Courts for review and a conference was held by the Commission with the Council in August, 1958, at Denver, Colo. No further action was taken on these bills by the Congress."

Mr. David Ferber, solicitor for the SEC, and others on his staff wrote an article in the 1959-60 George Washington Law Review (28 Geo. Wash. Law Rev. 319) in which they discuss conflicts of interest and state in a footnote on page 382 that HR 589 [sic] in the 85th Congress was sponsored by the SEC for the purpose of prohibiting a

trustee or his attorney from being employed by a reorganized company for a period of two years after substantial consummation of a plan. We suggest that the SEC knows that this is a matter to be determined by Congress, that the Fifth Circuit decision has interpreted correctly the statute as presently written, and that this court should not add a restriction not expressed or clearly implied in the existing law.

There is, as admitted by the Solicitor General, no decision on this issue contrary to the opinion of the Fifth Circuit sought to be reviewed.

THE CONTENTION THAT CERTAIN STOCKHOLDERS SHOULD BE AFFORDED OPPORTUNITY TO PARTICIPATE IN THE REORGANIZED DEBTOR.

The brief of the Solicitor General erroneously assumes that large numbers of stockholders are entitled by law to assert claims against the debtor and that they have been improperly prevented from doing so. The position of the Trustee is that in addition to such claims being barred by laches, the facts in the record with respect to the alleged merits of the claims show clearly that they would be without merit and, if established, would necessarily be subordinate to the claims of existing creditors.

The Solicitor General implies that the district court did not consider the alleged stockholder claims on their merits, but summarily disposed of them solely because the debtor was insolvent and the claims not timely filed. This is not accurate because the denial of the two claims filed shows that the facts upon which they were based were

considered by the court. The complete statement of the court on the subject says:

> "Another proposal, however, was that certain stockholders should be permitted to participate as unsecured creditors upon filing and proving up claims based on rescission of their purchase of the stock. There is nothing in the record of these proceedings to indicate that any stockholders have any claims against the debtor that would permit them to recover on such a theory, which is intended to cover stockholders *who acquired their stock on the open market* and not from the debtor. No such claims had theretofore been filed and the time for filing claims expired several years ago. The proposal would arbitrarily set aside 25% of the common stock under the Internal Plan for the benefit of stockholders who could prove a right to rescind. The equity of the unsecured creditors cannot be diluted in this manner.
>
> The Stockholders' Committee also filed a PROOF OF CLAIM FOR RESCISSION on behalf of unnamed stockholders who purchased stock of the debtor on the open market. The facts stated in this document are insufficient to show that any stockholders as a class or individually have valid claims against the debtor. Furthermore, the claim is filed too late and is vague and indefinite as to who the claimants are and the extent and amount of their claims. It is too nebulous to delay reorganization at this stage.

Likewise, the claim filed by Irma S. Mason, wife

> of a member of the Stockholders' Committee, seeking to rescind her purchases of TMT stock on the open market is without merit for the same reasons. It shows that her damages, if any, are recoverable against others than the debtor."
> (II 379-380)

The above shows clearly that the court considered the factual basis for the assertion of the claims and rejected them primarily on their merits.

The facts with respect to the claim of stockholder Irma S. Mason are asserted fully in her claim (II 358-363) including reference to the facts developed in the Trustee's 1960 investigation. (II 579-617) She seeks to recover from the *debtor* what she paid for her stock *on the open market* more than nine months before the reorganization proceedings began. She seeks to *rescind* her purchase and hold the *debtor* liable for the purchase price because of an alleged conspiracy between the debtor and its financial advisors which resulted in the market being flooded with "illegally issued stock" of which hers is *probably* a part.

The other claim (II 363-368) was filed by the Stockholders Committee "on behalf of all non-management stockholders" and seeks to rescind purchases made on the open market. Both claims list a series of facts intended to show that the stock was dumped on the open market by persons closely associated with the debtor who should have held the stock for a certain period under the securities laws, and that the public was misled as to the financial condition of the debtor by various statements and reports which were not accurate. Most of the facts relied upon were detailed in the Trustee's Report of Investigation (II 579-617) with

which the court and all parties had been familiar for more than two years prior to the filing and denial of the two claims.

It is therefore obvious that the district court denied the stockholder claims on their merits based on sufficient facts in the record to show their character. That they should be without merit as a matter of law is apparent upon careful analysis. There is no privity whatever between these stockholders and the debtor and ordinarily a defrauded buyer's right to rescind his purchase exists only against the person who sold the subject matter to him. Rescission implies that the parties can be restored to the status quo which existed prior to the alleged fraud. But that cannot be done as the considerations for the purchases of the stock were not paid to the debtor but to persons in the open market. The district court properly indicated that the remedy was against persons other than the debtor.

The effect of the position taken by opposing counsel would be to make the debtor the underwriter of all the market losses in the corporation's stock simply by virtue of stock having been put on the market that should not have been resold by the "insiders" involved. We have found no authority for such a position and none is cited in the opposing briefs.

Even if stockholder rescission claims were allowed they would necessarily be subordinated to the claims of trade creditors and lenders. All of the cases cited by the Solicitor General in the footnote on page 19 of his brief, as authority for the statement that such claims would rank on a parity with general unsecured creditors, arise from national bank liquidation under the National Bank Act.

(12 U.S.C. Sec. 21 et seq.) This act provides that "the comptroller (of currency) shall make a ratable dividend of the moneys so paid over to him by (a) receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction." (12 U.S.C. Sec. 194.) Distribution thus is not entrusted to a court of equity empowered to determine the order of distribution, but to an administrative official bound by a statute which directs ratable distribution *on all claims.* The unique nature of national bank proceedings was noted by this court in *Cook County* v. *United States,* 107 U.S. 445, where it was faced with the question as to whether the United States' statutory priority of payment for debts due to it applied in a case of an insolvent national bank. The court stated that

> " . . . the act authorizing the formation of national banks . . . constituting by itself a complete system for the establishment and government of national banks . . . Everything essential to the formation of the banks, the issue, security, and redemption of their notes, the winding up of the institutions, and the distribution of their effects, are fully provided for, as in a separate code by itself, *neither limited nor enlarged by other statutory provisions with respect to the settlement of demands against insolvents or their estates.*" (107 U.S. at 448) (emphasis supplied)

This court held that R.S. 5236 (12 U.S.C. Sec. 194) "provides for the distribution of the entire assets of the bank, *giving no preference to any claim* except to moneys to reimburse the United States for advances in redeeming notes." *(Id.* at 450) (emphasis supplied)

The proposition propounded by the *Cook County National Bank* case that the statutes with respect to national banks require ratable distribution without regard to other statutory priorities or other equities has been consistently adhered to.

In *Texas & Pacific Railway Co.* v. *Pottorff*, 291 U.S. 245, 255, Justice Brandeis stated in the course of considering whether national banks had power to pledge their assets to secure a private deposit, that to permit such pledge "would be inconsistent with many provisions of the National Bank Act which are designed to insure, in the case of disaster uniformity in the treatment of depositors and a ratable distribution of assets."

Even apart from the *mandatory* ratable distribution requirement of 12 U.S.C. 194 (contrary to all equity principles of receivership and reorganization), the three cases cited by the Solicitor General do not support the proposition that claims of defrauded stockholders who rescind their open market stock purchases against the debtor are entitled to rank on a parity with other unsecured ~~stock-holders~~ CREDI[illegible]. In each of the cases the defrauded stockholder dealt directly with the bank or its officials.

In *Clark* v. *Boston-Continental National Bank*, 84 F.2d 605, 607 (C.A. 1, 1936) plaintiffs were induced by the fraud of the president of the national bank to make loans to certain stockholders upon the security of their shares of stock. The bank closed forever sometime after the loans. The issue in the case was:

> "whether . . . the plaintiff, as judgment creditors of an insolvent bank, having paid the assess-

ments levied against them as stockholders, may participate ratably with other creditors in a distribution of the assets of the bank in the hands of the receiver."

The court held that the plaintiff should participate ratably with other creditors.

In *Salter* v. *Williams*, 244 Fed. 126 (C.A. 3, 1917) again the national bank made false representations to Salter to induce him to purchase stock *owned by a borrower* from that bank in order to reduce that borrower's indebtedness. In order to effect the purchase by Salter, the national bank made a loan to him. Upon the bank's failure, Salter met his liability as a shareholder by paying his statutory assessment. The court correctly reasoned that to deny Salter his right of rescission would result in a curious oversubscription of the bank's capital. That is to say, the creditors of the bank would have received the benefit of the purchase price of the shares in question on original issue, the benefit of the assessment paid by Salter as a stockholder and the amount paid by Salter to the bank for the stock in order to effect the reduction of a borrower's loan from the bank.

It is only in *Oppenheimer* v. *Harriman National Bank & Trust Co.*, 301 U.S. 206, that the actual question is presented as to rescission by a shareholder of a purchase from a national bank of its stock induced by fraudulent representations made by its officers. The crux of Mr. Justice Butler's decision is that "discrimination against their claims is not authorized by statute" and the statute to which he was referring was 12 U.S.C. Sec. 194 which es-

chews all principles of legal and equitable priority. As in the other cases, the stockholder had paid his assessment and this court held that his judgment for damages upon his rescission of the sale of the stock was entitled to rank on a parity with other unsecured creditor's claims.

Other than these National Bank cases, we find it uniformly held that stockholder rescission claims, even where corporate fraud exists are subordinated to the rights of creditors.

In cases involving insolvent *state* banks (the rigidity of the National Bank Act being inapplicable), stockholders who had been induced to purchase stock by false representations are subordinated to the rights of depositors and other innocent general creditors. See, *e.g.*, *Green* v. *Stone*, 205 Ala. 381, 87 So. 862 (1921); *Davis* v. *Burns*, 173 S.W. 476 (C. App. Tex. 1915); *Burleson* v. *Davis*, 141 S.W. 559 (C. App. Tex. 1911).

Rescission claims by stockholders have been subordinated to creditor claims in bankruptcy proceedings:

> "The law of the domicile of this bankrupt corporation in which appellant is a stockholder, and the great weight of authority, are that, given a corporation insolvent and unpaid subscriptions, corporate fraud inducing the subscriptions affords no stockholder a defense to collection, or ground for rescission, or basis for trust or lien, to the prejudice of corporate creditors. A fortiori, nor in respect to stock subscriptions paid." (Citing other cases)

* * * * *

> "However ignorant appellant of corporate insolvency and transactions, he knew the corporation was engaged in business, and might, as it did, incur debts. Hence he was charged with notice and knowledge of corporate status and acts, so far as creditors were concerned. That no creditors knew he was a stockholder is immaterial. Credit is given to corporations, with little or no knowledge of names of stockholders, but with confidence that, whoever they are, their rights in and to corporate property are subordinate to the rights of creditors."
> *In re Irving Whitehouse Co.*, 293 Fed. 287 (C.A. 9, 1923).

It is apparent from the authorities cited that if stockholder rescission claims were to be allowed, the court would have to classify them as inferior to the claims of general creditors under the broad and equitable classification powers provided in Section 197 of the Bankruptcy Act.

It is inequitable to allow parity treatment of stockholders' rescission claims because the claimants bargained for equity-type profits and assumed equity-type risks. In contrast, orthodox creditors dealt with the corporation with the expectation that they would have a senior position as against its assets to that of stockholders. They bargained for debt-type profits and certainty of payment.

This basic difference exists even where a corporate management has been guilty of the grossest fraud. When (as here) both creditors and stock purchasers have been defrauded, the equities obviously favor the former over the latter. A defrauded stock purchaser always has an option

to ratify his purchase and thus is able to straddle the future prospects of the manipulated company. If things go well, he shall be a stockholder, and if things go poorly, he shall be a creditor. This straddle is inequitable at least vis-a-vis unsatisfied creditors.

The history of the Stockholders Committee in this proceeding shows the most flagrant straddling. Initially it claimed that the debtor might be solvent (I 128-134) but at least as early as July 1, 1960, when the Report of Investigation was filed, it had knowledge that the market had been flooded with stock that should not have been resold. Thereafter, for nearly 2 years the Committee failed to file a single rescission claim, nor did any stockholder file a claim. It was only *after* the valuation hearings were concluded, and it was apparent that the debtor was hopelessly insolvent, that the Stockholders Committee filed a claim on behalf of a stockholder. That stockholder, Irma S. Mason, is the wife of Malcolm S. Mason, one of the attorneys for the Stockholders Committee and is herself an attorney.

No other stockholder has come forward with a claim in all the years involved in this reorganization. The Solicitor General speaks of the Trustee having ignored the claims of stockholders, while actually there were none to be ignored other than Mrs. Mason's. He suggests on page 20 of his brief that the Trustee should "have devised a procedure pursuant to Section 196 to determine the legal questions before formal proofs of claims would have had to be filed." We suggest that it would be the duty of the Stockholders Committee to suggest some "procedure" *after* it had found some stockholders who wanted to assert

claims. Apparently the Solicitor General wants the Trustee and the court to *invite* the filing of claims by stockholders.

Mrs. Mason is estopped to assert that her claim is timely filed because she is the attorney-wife of counsel of record for the Stockholders Committee. As to the class claim filed on behalf of all "non-management stockholders", we can find no provision in the Bankruptcy Act for the filing of such a claim for unknown claimants in unknown amounts. Section 209 authorizes any creditor or stockholder to be represented by a committee, but Sections 210 and 211 (4) require the filing of names and addresses and a statement showing the claims or stock represented.

All of these circumstances led the district court to the conclusion that the Stockholder Committee claims were, in effect, not filed in good faith and were too vague, indefinite and nebulous to warrant serious consideration and further delay in approving a plan of reorganization.

THE CONTENTION THAT COMPROMISES OF MAJOR CLAIMS WERE IMPROPERLY APPROVED BY THE COURT.

We have outlined in our Brief in Opposition to the Petition herein the numerous hearings held by the district court when the plan of reorganization was being considered. Among the matters thoroughly considered by all parties and the court were the compromises of the Merrill-Stevens and Caplan mortgage claims. It is true that the Trustee filed objections to these claims and, together with his counsel, examined a mass of evidentiary matter that led to the filing of the objections. It is quite another matter, however, to decide whether to litigate complicated and

contested issues when there is the responsibility to formulate a plan of reorganization and conclude the expensive litigation that has prolonged these proceedings and has been a heavy burden on the debtor.

The provisions in the reorganization plan for the compromise of these claims were arrived at after intensive investigation and a prudent evaluation of the results and of the law, and reflect a fair adjustment of the equities. The district court's findings stated:

> "While the vessel valuation proceedings were in progress and before any of the lien adjudication and marshalling proceedings had begun, the trustee and the unsecured creditors committee appointed by the court to represent that class of creditors were given informal permission by the court to contact the principal lien and priority claimants for the purpose of attempting to compromise and settle the issue involving such claims. This was deemed wise because it was apparent that the liquidation of the issues involved, particularly the objections to the Caplan and Merrill-Stevens claims, would take possibly years to conclude and it was the opinion of the court as well as the trustee and the creditors committee that the financial success of the trusteeship required the early reorganization of the debtor if at all possible.
>
> Negotiations by the trustee and the creditors committee resulted in proposed compromises of the Caplan mortgage claim and the Merrill-Stevens claims, which compromises are included

in the Internal Plan of Reorganization, initially filed by the creditors committee. It is the opinion of the court that these compromises are fair and equitable under the circumstances and they are hereby approved for inclusion in the Internal Plan. The court approves the opinion expressed by the attorney for the trustee that no better compromises can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would otherwise be required, and that the prospect of recoveries beyond the amount of the claims as urged by the Securities and Exchange Commission and the Stockholders Committee is too remote for serious consideration. If the unsecured creditors approve the Internal Plan with these compromises, the only class that can object are the stockholders, and the court has found in the Valuation and Insolvency Order that the stockholders have no equity even if these two claims were disallowed in toto. The alternative to approval of these compromises is extensive litigation at heavy expense to the debtor and unnecessary delay in reorganization contrary to the intent and purpose of Chapter X of the Bankruptcy Act. (II 372-373)

With respect to the Merrill-Stevens claim and the proceedings and investigations which took place prior to the court's findings quoted above, we include as an appendix hereto portions of the Trustee's MOTION FOR ALLOWANCE OF CLAIM which outline the background of the settlement. A hearing was held on this motion (II 35-40) at which objections were heard, and thereafter the nego-

tiations took place which resulted in the compromise. We can do no more than repeat here what we told the district court when the issue was heard (II 35-36), namely that the factual data which we studied with respect to the claim led us to the conclusion that the possibility was remote of obtaining any material reduction in the amount of the claim by litigating the objections, and that any such litigation would be time consuming and expensive to the debtor and would result in unnecessary delay in forming the plan of reorganization.

About three years later the Stockholders Committee asserted that it had uncovered more facts concerning the Merrill-Stevens claim (III 16-20) and these facts were considered by us in the light of our previous investigation. After hearing, the court rejected the effort to reopen the matter. (III 73-74)

Regarding the Caplan mortgage claim, the facts were fully developed in the Trustee's investigation in 1960. (II 597-615) The settlement reduced the claim from the face amount of $330,000 plus interest, costs and attorneys fees to $250,000 plus an interest item to be paid in the new common stock of the reorganized company. Again, it was our opinion that this was a fair compromise under the circumstances and we recommended its approval.

The approval of a compromise is an exercise of judicial discretion, which should not be disturbed unless the court acted arbitrarily or clearly abused its discretion. *Daniel Hamm Drayage Co.* v. *Willson*, 178 F.2d 633, 635 (C.A.8, 1949); *In re Prudence Co., Inc.*, 98 F.2d 559, (C.A. 2, 1938) *cert. denied sub. nom. Stein* v. *McGrath*, 306 U.S.

636; *In re Kalamazoo Building Co.*, 21 F.Supp. 852 (D.C. Mich. 1937).

The cases cited by the Solicitor General in support of his contention that the district judge did not have sufficient information before him to make "an informed independent judgment" on the compromises involved situations materially different from the case here. *National Surety Co.* v. *Coriell*, 289 U.S. 426, concerned approval of a *plan of reorganization* in which there was no valuation of the assets, no dependable schedule of liabilities, no evidence that a majority of the unsecured creditors favored the plan with respect to which "The receiver submitted no facts and made no recommendations." *National Surety Co., supra* at 435. *Ashbach* v. *Kirtley* 289 F.2d 159 (C.A.8, 1961) involved a $521,000 *judgment* settled for $105,000 which the appellate court reversed because of "the paucity of information furnished to the court by the trustee and his counsel." We have shown above that the district court had a great deal of information before it regarding the nature and background of the Merrill-Stevens and Caplan mortgage claims.

The case of *In re Chicago Rapid Transit*, 196 F.2d 484 (C.A. 7, 1952) set aside a settlement requiring *payment by the debtor* of $1,125,000 in compromise of certain claims "solely on the basis of expediency" where only 40% of security holders concerned favored the settlement and 11% opposed it. The court stated principles to be followed in approving settlements that are applicable to our situation:

> "And even in bankruptcy matters, which often involve many diverse interests, where any reason-

> able basis for compromise settlements appears they should be encouraged, and the bankruptcy court has broad discretion to approve them. It may be that acceptance by a large majority of creditors and opposition by an inconsequential number or amount would of itself constitute a reasonable basis for approval by the court without consideration of the merits of the claim or claims thus disposed of."
> *In re Chicago Rapid Transit*, supra, p. 490.

No creditor objected to the two compromises here and the plan of reorganization incorporating the settlements was accepted by overwhelming vote of the creditors in 1962 (II 387.8) and again in 1965. (III 325)

The creditors, of course, were the only parties concerned in the compromises since the debtor was insolvent and the stockholders had no equity. If the two compromised claims had been disallowed *in toto*, the debtor would have remained insolvent. Under all of these facts and circumstances it cannot be said that the lower courts acted arbitrarily or abused their discretion in approving the compromises.

THE DEBTOR IS INSOLVENT AND THE STOCKHOLDERS MUST BE EXCLUDED FROM PARTICIPATION.

The Solicitor General ignores the abundance of valuation evidence, as outlined in our initial brief, and contends that the district court applied "an erroneous method of valuation." The court thoroughly considered all of the evidence and made the going concern valuation by capital-

izing the peak earnings under the trusteeship. (II 387.5-387.7) Future earnings after reorganization and under anticipated different operating methods were not estimated because they would be entirely speculative and uncertain.

The Trustee testified that ". . . there are too many unknown factors. I could not possibly make a prediction." (II 108) The court said it ". . . will not attempt to guess what future management might do with the company after reorganization." (II 387.7)

After the 1962 valuation finding the earnings of the debtor declined, and based upon additional evidence taken in 1965 (III 120-212, 75-82) the court reaffirmed its finding of insolvency. (II 266-268)

Nothing will be found in the district judge's decisions inconsistent with this court's opinions in *Consolidated Rock Products, Inc.* v. *DuBois*, 312 U.S. 510 or *Institutional Investors* v. *Chicago, M. St. P.&P.*, 318 U.S. 523. The appellate court held that the district judge did not abuse his discretion and that his findings were not clearly erroneous.

CONCLUSION

It should be apparent that this case does not involve any novel questions of law or application of any erroneous legal principles requiring review by this court. It concerns issues of fact, contested through many years in the lower courts.

This court has stated that it should not be invited ". . . to reach conclusions from the voluminous record in

the case, contrary to those reached by the two courts below" such findings being "final here in the absence of very exceptional showing of error." *Comstock* v. *Institutional Investors*, 335 U.S. 211, 213-214.

We respectfully submit that no error has been shown and that the petition for a writ of certiorari should be denied.

Wm. P. Simmons, Jr.

William P. Simmons, Jr.
of SHUTTS & BOWEN
1000 First National Bank Bldg.
Miami, Florida 33131
Attorney for Respondent

Dated: May 16, 1967